No. 618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

ESTATE OF HENRY H. ROGERS, deceased, ALBERT STICKNEY and CENTRAL HANOVER BANK AND TRUST COMPANY, as Surviving Executors of the Last Will and Testament of HENRY H. ROGERS, deceased, *Petitioner,*

against

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Dated, New York, N. Y., October 20, 1944.

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TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The Estate of Henry H. Rogers, Albert Stickney and Central Hanover Bank and Trust Company, as surviving executors, petitions for a Writ of Certiorari to review the decision of the Circuit Court of Appeals for the Second Circuit in its judgment entered on July 24, 1944, which affirmed a decision of the Tax Court of the United States entered on March 31, 1943, sustaining in part a deficiency in Federal income taxes for 1937 asserted by the Commissioner of Internal Revenue.

Summary Statement of the Matter Involved

The three issues involved relate solely to the method of taxing what is concededly capital gain. There is no question of tax evasion, but only when the gain should be taxed, to whom, and at what holding period rate.

The executors of the petitioner Estate sold in 1937 certain stock forming a part of the Estate, for a consideration more than 70% of which consisted of collateral trust serial notes of the purchasing corporation. In the Estate's income tax return the executors elected to report the gain on the installment basis; the Tax Court has held this proper, and no appeal was taken from its holding on this point.

Later in 1937 the executors caused some of the notes to be eliminated from their accounts as executors and entered upon their accounts as residuary trustees under the decedent's will, and caused other notes to be allocated to an escrow agent for a residuary legatee. The Commissioner of Internal Revenue, by an amended answer in the Tax Court, contended that these bookkeeping transactions constituted a distribution, transmission, sale or other disposition of these notes within the meaning of Section 44(d) of the Revenue Act of 1936, and that accordingly, the entire gain represented by these notes became taxable to the Estate in 1937, producing a deficiency in income tax for that year of $487,053.58.

Against the point raised in the Commissioner's answer, petitioner made three contentions, upon which it still relies: first, that the shift of the installment obligations from one account to another not only was not the type of event which Congress intended to reach in Section 44(d), but also was not an event of sufficient substance to justify the imposition of any income tax; second, that even if an event of the type specified in Section 44(d) did take place, and an immediate capital gain "resulted" to petitioner in 1937, petitioner is entitled to deduct the amount of gain as an amount of income properly paid to legatees under Section 162(c) of

the Revenue Act of 1936; and third, that if a gain was realized by petitioner by reason of such alleged distribution, the proper holding period, for the purpose of determining the percentage of such gain to be taken into account under Section 117(a) of the 1936 Act, was not merely the period during which the executors had held the original stock received from the decedent, but consisted of the period from the decedent's death to the date the notes into which the stock had been converted were transferred to the trusts and the residuary legatee.

The Tax Court held against the petitioner on all three contentions, and the Circuit Court of Appeals affirmed.

Statutes Involved

The statutes involved in this case are the following provisions of the Revenue Act of 1936 (c. 690, 49 Stat. 1648; 26 U. S. C. A. 813):

Section 44(d):

> "(d) *Gain or Loss upon Disposition of Installment Obligations.*—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. This subsection shall not apply to the transmission at death of installment obligations if

there is filed with the Commissioner, at such time as he may by regulation prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the person receiving any payment on such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and had received such payment."

Section 162(c):

"(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary."

Section 117(a):

"(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income: * * *

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years; * * *."

Questions Presented

1. Did the petitioner distribute, transmit, sell or otherwise dispose of certain installment obligations during the year 1937 within the meaning of Section 44(d) of the Revenue Act of 1936?

2. Assuming the petitioner did distribute, transmit, or otherwise dispose of the installment obligations in 1937 to residuary trusts created under the will of petitioner's decedent and to a residuary legatee, is the petitioner entitled to deduct the amount of gain thereby resulting as an amount of income properly paid to legatees under the provisions of Section 162(c) of the Revenue Act of 1936?

3. Assuming the petitioner did realize a gain from the allocation of the installment obligations to the residuary trusts and the residuary legatee in 1937, does the proper holding period, for the purpose of ascertaining the percentage of gain to be taken into account in computing net income under Section 117(a) of the Revenue Act of 1936, include not only the time the Estate held the original stock, but also the time it held the notes into which the stock was converted?

Statement of This Court's Jurisdiction to Review

The judgment of the Circuit Court of Appeals was entered on July 24, 1944. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (c. 229, 43 Stat. 938; 28 U. S. C. A. § 347(a)).

Reasons Why the Writ of Certiorari Should Be Issued

I. *As to the question of a "distribution" under Section 44(d).*

In holding that the shift of the notes from the executors' accounts to the trustees' accounts was a distribution of the notes for income tax purposes, the Circuit Court of Appeals decided a Federal question in a way probably in conflict with applicable decisions of this Court.

The decision of the court below on this issue conflicts in principle with *Brewster* v. *Gage*, 280 U. S. 327 (1930);

Maguire v. *Commissioner,* 313 U. S. 1 (1941); *Helvering* v. *Gambrill,* 313 U. S. 11 (1941); *Helvering* v. *Campbell,* 313 U. S. 15 (1941); *Helvering* v. *Reynolds,* 313 U. S. 428 (1941); and *Cary* v. *Commissioner,* 313 U. S. 441 (1941), and the view of the Circuit Court of Appeals that its decision was controlled by *Helvering* v. *Gambrill* arises from an erroneous interpretation of what was decided in that case. These cases show that a remainderman acquires his interest in estate property, and that the property is distributed to him, at the time the executor acquires it; in the present case, however, the tax has been sustained on the theory that a "distribution" was made at a later date, by bookkeeping entries.

In the *Maguire, Gambrill, Campbell, Reynolds* and *Cary* cases, all decided in 1941, this Court made a careful and comprehensive analysis of the question of when, for income tax purposes, a remainderman under a testamentary trust acquires his interest either in the decedent's property or in assets purchased by an executor or trustee with estate funds. In each case, the remainderman asked this Court to decide that the time of acquisition by him was the date the testamentary trustee actually delivered the property into his hands. In all five cases this Court, integrating its holdings with the fundamental doctrine already laid down in *Brewster* v. *Gage,* refused so to rule, and held that Congress, with one exception, had singled out the date of decedent's death or the date of the fiduciary's purchase as the crucial point of time as of which the remainderman should be deemed to have acquired his interest in the property for income tax purposes. Forced to qualify its general rule because of the special provision of the 1928 and 1932 Revenue Acts for determining the basis of general bequests of personalty, the Court gave effect to this Congressional exception for the years these Acts were in force and held that for this one limited purpose the focal transaction was the transfer from executor to testamentary trustee.

In *Maguire* v. *Commissioner* this Court recognized an important and necessary corollary to the meaning of the word "acquisition" as applied to a remainderman, by hold-

ing that for income tax purposes "acquisition" and "distribution" occur simultaneously. In other words, a remainderman has property distributed to him at the time he acquires his interest therein. Accordingly, since the focal date adopted by Congress in the 1934 and later Acts is either the date of death or the date of the fiduciary's purchase, transfers between fiduciaries in the course of effectuating a decedent's wishes subsequent to the one time that is crucial for income tax purposes are without significance and must be disregarded. As applied to the present situation, this means that the three residuary trusts and the residuary legatee had the notes distributed to them at the moment the notes were acquired by the executors, and that all later transfers in the chain of devolution were without any income tax significance. In this connection, it should again be noted that the present case is governed by the 1936 Act, which embodies the general rule, and not by the 1932 Act, which was the last statute to contain the special exception.

The court below, in seeking guidance from these decisions as to the proper interpretation of "distributed" in Section 44(d), apparently allowed itself to be unduly influenced by the fact that its decision in *Commissioner* v. *Gambrill*, 112 Fed. 2d 530 (C. C. A. 2d, 1940), was reversed by this Court. It failed to recognize that this Court, in deciding the *Gambrill* case, attributed a special income tax significance to the transfer of property from executors to trustees only to the extent required by the particular change made in the Revenue Acts of 1928 and 1932 for determining the basis of a general bequest of personalty, and that this 1928-1932 change was only a "limited departure" (313 U. S., p. 8) from the general rule as to basis obtaining prior to 1928 and re-adopted by Congress in the 1934 Act. *Maguire* v. *Commissioner*, and *Helvering* v. *Reynolds*, *supra*. The decision below, therefore, is out of line with the principles so carefully and fully laid down by this Court in the five cases decided in 1941.

In its holding on this first issue, moreover, the Circuit Court of Appeals has decided an important question of

Federal law which so far has not been passed upon by this or any other court, save in this proceeding, and which should be settled by this Court. Inasmuch as the point decided is entirely new and is of great importance in the administration of decedents' estates, in so far as that activity is subject to Federal income tax, it is essential for the proper functioning of the Internal Revenue Laws that the point decided should be settled by this Court, both for the information of all concerned and to avoid further litigation.

II. *As to the question of a deduction under Section 162(c).*

In ruling against petitioner's contention that if a capital gain resulted petitioner was entitled to deduct it as income properly paid or credited to legatees, the Circuit Court of Appeals again decided a Federal question in a way probably in conflict with an applicable decision of this Court.

The decision of the court below on this issue conflicts with *Helvering* v. *Butterworth*, 290 U. S. 365 (1933). In that case a testamentary trustee, having paid income of the trust to the decedent's widow, claimed a deduction therefor, under Section 219 (b) of the Revenue Act of 1924, as an amount of trust income which was to be distributed currently by the fiduciary to the beneficiary. In support of his disallowance of this deduction, the Commissioner contended that the widow had elected to accept the provisions of the trust in lieu of her statutory rights in the decedent's estate, and hence that the payments to her could not be taxed to her or deducted by the trustee until they had amounted to the value of what she had relinquished. This was the equivalent of a contention that the widow had received the amounts in question as exempt corpus rather than as taxable income. This Court refused to adopt the Commissioner's contention, and thus in effect ruled that the character of a payment as income does not change as it passes through the hands of a fiduciary, but remains taxable to the actual ultimate recipient thereof.

The effect of the decision of the court below is to tax the capital gain here involved to the persons who distributed it instead of to the persons who received and retained it. This erroneous result arises from the concept that the capital-gain component of the installment obligations somehow loses its character as income when transferred from one fiduciary to another. *Helvering* v. *Butterworth* held that Congress intended otherwise, and the decision below is in direct conflict therewith.

The warning in the *Butterworth* case to the effect that a tax statute and the will of Congress are under inquiry casts considerable doubt, moreover, upon the propriety of the lower court's dependence in this case upon the language of the decedent's will in the light of local New York decisions and the accounting procedures which took place thereunder. This Court, in *Lyeth* v. *Hoey,* 305 U. S. 188 (1938), *Burnet* v. *Harmel,* 287 U. S. 103 (1932) and other cases, has held that where the meaning of words and concepts used in a Federal statute is involved, Federal law has its own criteria, and local laws are without controlling effect. It is peculiarly appropriate here that Federal criteria should control, inasmuch as the type of capital gain said to result in this case is not the usual one resulting from the ordinary sale of assets but is a specially accelerated gain engendered by the unique provisions of Section 44(d). By failing to approach this as an original Federal question, the court below fell into an error which should be corrected here.

Here again, the decision of the court below on this second issue raises an important question of Federal law which so far has not been passed upon in a case where installment obligations are involved by any tribunal, except in this proceeding. This issue is new so far as installment obligations are concerned, although the Commissioner himself has reached the result we contend for in a published ruling. I. T. 2589, C.B. December, 1931, page 156. Various Circuit Courts, attempting to apply this Court's decisions in

Burnet v. *Whitehouse,* 283 U. S. 148 (1931), *Freuler* v. *Helvering,* 291 U. S. 35 (1934), and other cases passing on Section 162 or its counterparts in the various Revenue Acts, have reached divergent views as to when a capital gain realized by an executor or trustee may be deducted by such fiduciary when distributed to a beneficiary. Although the divergence may be explained by the disposition of the various Circuit Courts to rest their decisions upon local laws which vary from jurisdiction to jurisdiction,* the result is great confusion in the application of the Federal income tax to decedents' estates in the course of administration. This confusion might well be obviated by this Court's reexamining the whole question of whether the character of income is affected by its passing through the hands of a fiduciary, so far as its ultimate taxability to the beneficiary is concerned.

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* See *Weigel* v. *Commissioner,* 96 Fed. 2d 387 (C. C. A. 7th, 1938); *County National Bank & Trust Co.* v. *Helvering,* 122 Fed. 2d 29 (C. A. D. C., 1941); *Anderson's Estate* v. *Commissioner,* 126 Fed. 2d 46 (C. C. A. 9th, 1942); *Commissioner* v. *Crawford's Estate,* 139 Fed. 2d 616 (C. C. A. 3d, 1943); *Commissioner* v. *Bishop Trust Co.,* 136 Fed. 2d 390 (C. C. A. 9th, 1943); *Weber* v. *Commissioner,* 111 Fed. 2d 766 (C. C. A. 2d, 1940). Most of these cases rely on a dictum of *Burnet* v. *Whitehouse, supra,* that the predecessor of Section 162 applies "only to income paid as such to a beneficiary" (283 U. S., p. 151). From this they deduce the further rule that whether income is "paid as such" is a matter of local law. We submit that no such inference is required by the *Whitehouse* case. The question there involved was whether an annuity charged against a whole estate was exempt from tax under the predecessor of Section 22(b)(3) as a bequest of corpus. The dictum was in answer to an attempt of the Commissioner to integrate Section 22(b)(3) with Section 162.

III. *As to the question of holding period under Section 117(a).*

In restricting the applicable holding period (for the purpose of determining the percentage of gain to be taken into account) to the period during which the executors held the original stock, the court below decided an important Federal question which has not been but should be decided by this Court. The court below, apparently thinking that Section 44(d) was not clear, permitted itself to be governed exclusively by a statement in the Congressional Committee Reports; and it gave no effect to the explicit statutory direction that on disposition of an installment obligation gain or loss "shall result", and that "Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received." Under this plain language we submit that the holding period begins with the date the original property was acquired by the executors and ends with the disposition by the executors of the obligations into which the original property has been transformed. Again, this is a question of general importance in the administration of the Federal revenue laws which has not been passed upon by this or any other court, except in this proceeding.

Prayer

For the foregoing reasons, your petitioner prays that a writ of certiorari be issued out of this Court to the United States Circuit Court of Appeals for the Second Circuit, commanding said court to certify and send to this Court, on a day to be determined, a full and complete transcript of the record of all of the proceedings of said Circuit Court of Appeals had in this case, to the end that this cause may be reviewed and determined by this Court; that the judgment of the Circuit Court of Appeals be reversed with re-

spect to the decision of the issues here presented; and that petitioner be granted such other and further relief as may be proper.

Estate of Henry H. Rogers, *Deceased*,
Albert Stickney and Central Hanover Bank and Trust Company, *as Surviving Executors, Petitioner*,

John W. Drye, Jr.,
Counsel for Petitioner.

Dated: New York, N. Y., October 20, 1944.

BRIEF IN SUPPORT OF PETITION

The purpose of this Brief is to amplify the Petition as regards the facts of the case and the reasons upon which petitioner relies for the issuance of the writ, but only to the extent these have not already been covered in the Petition.

The opinion of the Tax Court of the United States (23-39)* is reported at 1 T.C. 629. The opinion of the Circuit Court of Appeals (103-105) is reported at 143 Fed. 2d 695. Statements as to the statutes involved, the questions presented and this Court's jurisdiction to review are set out at pages 3-5 of the Petition.

Statement of Facts

All of the facts have been stipulated (24).

Henry H. Rogers died testate and a resident of New York on July 25, 1935. Adrian H. Larkin (now deceased), Albert Stickney and Central Hanover Bank and Trust Company were named as executors and trustees in the will and qualified in both capacities (24, 51).

Among the assets of the Estate at the decedent's death were 24,248 shares of the common stock of The Virginian Railway Company, which at that time had an aggregate fair market value of $1,454,880. On January 19, 1937 (in conjunction with similar sales by others) the executors sold these shares for a total consideration of $3,209,222, producing a gross profit realized or to be realized of $1,754,342, or 54.6656% of the total contract price. Of the total consideration received by the Estate, $2,400,000 was represented by collateral trust serial notes of the purchaser (The Virginian Corporation) taken at their face amount, maturing $72,000 in each year from 1940 to 1951 and the

* References are to pages of the Transcript of Record.

balance of $1,537,000 in 1952. These notes, together with others issued by the purchaser in similar transactions, were secured by the railway stock which the purchaser thus acquired and which constituted its only asset and activity (24-27, 52-55, 61).

In the Estate's 1937 income tax return the executors reported this transaction on the installment basis, returning as gain from the sale 54.6656% of the down payment,—as subsequently upheld by the Tax Court. As the stock had been held for more than one but less than two years (from date of death to date of sale), only 80% of the gain on the down payment was taken into account (26-27, 61-62).

Under the decedent's will, the residuary estate was to be divided into three equal shares and held in trust by the same three persons who were named as executors. The income of the three trusts was to be paid respectively to the decedent's widow, daughter and grandson, with remainders over, and in the event the widow remarried one-half of the share held in trust for her was to be paid over to the daughter (29-30, 64-87).

Following the receipt of the $2,400,000 of collateral trust notes, they were entered on the Estate's accounts as part of its corpus. On November 6, 1937 $1,250,000 of the notes were eliminated from the accounts of the Estate, transferred in the Bank's vaults from an envelope marked with the name and descriptive number of the Estate to envelopes similarly marked for the three trusts, and entered on the accounts of the three trusts,—$500,000 for the daughter's trust, $500,000 for the grandson's trust, and $250,000 for the widow's trust, as she had remarried. For this reason, an additional $250,000 of the notes were eliminated from the accounts of the Estate and were held by Central Hanover Bank and Trust Company in escrow for the daughter, under a receipt and refunding agreement whereby the interest was to be paid to her and the notes or proceeds thereof were to be held and returned to the Estate if the residuary estate should prove inadequate to pay all debts, claims and expenses. The executors' accounts for the

period including the year 1937 were approved by the Surrogate's Court; a schedule attached to one of the accounts, entitled "Payments of Principal to or on Behalf of the Beneficiaries", recorded the payment of $1,250,000 of the notes to the trustees of the three trusts and of $250,000 of the notes to the Bank as escrow agent for the daughter (30-31, 55-61, 89-99).

Each trust filed income tax returns for the years 1938-41. During these years some of the notes held by the trusts were sold or redeemed, and in the trusts' income tax returns the amounts so received were reported as gain from the payment of installment obligations, i.e., 54.6656% of the amount received was reported as gain to be taken into account at a proper percentage in computing net income. None of the amounts so received was distributed to the life beneficiaries of the trusts. All interest collected on the notes while held by the trustees was reported in the income tax returns of the respective trusts (31, 62-63).

Of the $2,400,000 notes received by the Estate in 1937, the remaining $900,000 were in 1939 eliminated from the accounts of the Estate in similar manner, $750,000 being entered on the accounts of the trusts in the same proportions as previously, and $150,000 held in escrow for the daughter (31, 61).

Argument

I

Under the provisions of Section 44 (d) of the Revenue Act of 1936, the privilege of reporting gain on the installment basis is terminated when the seller engages in one of the transactions specified in that section, and all the remaining gain is taxed at once in the year such transaction occurs. The Committee Reports on the Revenue Act of 1928, which added Section 44 (d) to the law, state:

> "Subsection (d) contains new provisions of law to prevent evasion of taxes in connection with the

> transmission of installment obligations upon death, their distribution by way of liquidating or other dividends, or their disposition by way of gift, or in connection with similar transactions."*

Although it is obvious that the shift of the notes in the present case from one set of accounts to another does not come within any of the specific purposes named in the Committee Reports, the court below has, by its reliance on the *Maguire* and *Gambrill* cases,** decided that the bookkeeping transactions herein amounted to a "distribution" of installment obligations under Section 44 (d). Correctly understood, however, these and three other cases*** decided in the same year give an entirely different meaning to "distribution".

Where property is acquired by a remainderman under a will there are three separate points of time which might be of importance for income tax purposes. The first is the date of death or (as to property purchased by the executor) the date of purchase; the second is the date when the executor hands over the property to the testamentary trustee; and the third is the date when the trust falls in and the trustee actually delivers the property to the remainderman. In each of the five 1941 cases the taxpayer contended that the third event controls, but this Court, after careful con-

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* Report of Committee on Ways & Means, Revenue Bill of 1928, 70th Cong., 1st Sess., H. Rept. 2, p. 16; Report of Senate Finance Committee, Revenue Bill of 1928, 70th Cong., 1st Sess., S. Rept. 960, p. 24.

There is no possibility of tax evasion where the "distribution" of an installment obligation is made by an executor to a testamentary trustee, as the trustee will take the same basis as the executor and will return all unrealized gain when and if collected (as the trustees did here). Regulations 94, Article 113 (a) (5)-1(e).

** *Maguire* v. *Commissioner*, 313 U. S. 1 (1941); *Helvering* v. *Gambrill*, 313 U. S. 11 (1941).

*** *Helvering* v. *Campbell*, 313 U. S. 15 (1941); *Helvering* v. *Reynolds*, 313 U. S. 428 (1941); and *Cary* v. *Commissioner*, 313 U. S. 441 (1941).

sideration of the whole question under all of the Revenue Acts theretofore enacted, reaffirmed the doctrine that fundamentally the significant event is that which occurs on the first date, i. e., date-of-death or date-of-purchase. Because of the special command of Congress in the 1928 and 1932 Revenue Acts that for determining the basis of general bequests of personalty the critical date is the date of "distribution to the taxpayer," the Court in the three cases under these Acts was forced for this one limited purpose to adopt the second date,—when the executor hands over the property to the trustee.

In the *Maguire, Gambrill* and *Campbell* cases, the opposing parties were neither of them asking this Court to approve the first date, but only to choose between the second and third dates. When this Court said that "distribution to the taxpayer" is not necessarily restricted to actual delivery to the taxpayer but also "aptly describes" the case where property is delivered by the executors to the trustees, this Court was of course in no sense holding or even implying that "distribution" would not also aptly describe the first date in cases not governed by the "limited departure" of the 1928 and 1932 Acts.* And when this Court came to deal with cases arising under the 1934 Act (*Helvering* v. *Reynolds* and *Cary* v. *Commissioner*), the Court again reverted to the date-of-death or date-of-purchase rule as the expressed intent of Congress.

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* See *Maguire* v. *Commissioner,* 313 U. S. 1, 7, 8, where this Court said: "In *Brewster* v. *Gage,* 280 U. S. 327, 334, this Court held under earlier acts that the date of death was the date of 'acquisition' even in case of a residuary legatee whose interest at the date of death clearly was not absolute. That conclusion suggests that the critical date is the time when the legatee acquires some interest in the property although his interest then may not be unconditional. Hence, in case of remainders governed by § 113 (a) (5) of the 1928 Act, it cannot realistically be asserted that the date when the remainderman acquired his interest came later than the time when he obtained an equitable estate under the testamentary trust."

The court below, apparently over-emphasizing the effect of the reversal of *Commissioner* v. *Gambrill,* 112 Fed. 2d 530 (1940), by *Helvering* v. *Gambrill, supra,* and taking the language of the *Maguire* case as to "distribution" out of its context, reached a result which is in direct opposition to the views of this Court as set forth in the 1941 cases and in *Brewster* v. *Gage.* Under the fundamental rule laid down by this Court distribution takes place when the remainderman acquires his interest in the property, i. e., at the date of death or date of the executor's purchase. In the present case, accordingly, the subsequent shift of the notes from the executors' to the trustees' accounts was an incidental step of no tax significance, and not one of the kind on which Congress thought it necessary to fasten the drastically accelerated tax under Section 44 (d).

II

The importance of the question as to whether the capital-gain (i. e. the income) component of an installment obligation becomes transmuted into corpus when the obligation is shifted from executors to themselves as trustees is so great, and its resolution by the court below so imbedded in the pattern of confusion which has emerged from other Circuit Court decisions, that the whole problem deserves reexamination by and illumination from this Court.

By the force of Section 44 (d) the executors of petitioner were in receipt of capital gain in 1937. They did not retain the gain so received but transferred it over, during the same taxable year, to their trustee accounts. The question upon which we are asking this Court to pass is whether what was admittedly income, and what was admittedly paid over in the same year with the approval of the local court in the course of carrying out the wishes of a decedent, retains its character as income, or loses it by the mere touch of the executors' hands.

Congress plainly intended that all estate income should be taxed to someone (see *Helvering* v. *Butterworth,* 290 U. S. 365 (1933)), and Section 162 evidences the desire of Congress that the person who should pay the tax on such income is the person who currently receives and retains it. The tax ought not to be imposed on the person who has distributed the income and thus parted with the wherewithal to pay the tax thereon, but on the person who has received and retained the income. We do not think that this sound principle of taxation should be subverted by the judge-made concept that Federal taxable income passing through a conduit can be changed by local law into Federal exempt corpus.

The confused development of this concept in various Circuit Court decisions, as we pointed out in the Petition on page 10 and its footnote, is grounded on a dictum in *Burnet* v. *Whitehouse,* 283 U. S. 148 (1931). The direct holding of that case, however, has been found out of harmony with sound principles of taxation, as shown by the action taken by Congress in Section 111 of the Revenue Act of 1942, amending Sections 22(b)(3) and 162. The Report of the Committee on Finance on the Revenue Bill of 1942 (77th Cong., 2d Sess., Senate Rept. No. 1631, p. 69 *et seq.*) states that the law is being changed, in the case of annuities payable at intervals, to provide that to the extent there is income in the estate from which the annuities are derived the payments shall be treated as income to the recipient regardless of whether the payments are made out of income or corpus. What Congress was changing was the rule laid down in *Burnet* v. *Whitehouse, supra,* and *Helvering* v. *Pardee,* 290 U. S. 365 (1933), both of which held in effect that income could become corpus in passing through the hands of a fiduciary and hence could be exempted from tax in the hands of the beneficiary. Although the 1942 amendments needed to deal only with recurrent payments rather than isolated capital gains, they recognized the basic principle for which we contend, namely, that the character of income is not changed by its passage through

the hands of a fiduciary. In this connection, the Committee Report is illuminating. It says, referring to the *Whitehouse* and *Pardee* cases:

> "This construction of existing law results in payment of the tax by the trust upon income received by a beneficiary, and, accordingly, in some cases furnishes an instrument for tax avoidance by the beneficiary and in some cases results in hardship to other beneficiaries whose share of trust income is reduced by the taxes paid for the benefit of another."

It is our earnest contention that the doctrine followed by the court below,—which would transmute income into corpus in the course of the devolution of a decedent's estate before that income reaches its destination—represents so marked a deviation from the real intention of Congress in this regard that the matter should be reviewed and corrected by this Court.

III

Since its enactment in 1928 Section 44 (d) has provided that if an installment obligation is distributed or disposed of, etc., "gain or loss shall result". The provision as to the applicable holding period on such an event was added by the 1934 Act, as follows:

> "Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received."

Thus the time at which the statute directs that the gain or loss shall "result" is the time at which the installment obligation is disposed of. And though the gain or loss actually results at that time because of the disposition of the obligation, the added sentence directs that it shall be considered as resulting (at that time) from the sale or exchange of the original property. The original property,

in other words, is to be considered as being continuously held down to the time at which the gain or loss results.

When a capital asset is disposed of the percentage of gain or loss under Section 117 (a) is ordinarily determined by the length of time the asset was held, which here would be the time the installment obligation was held. The added sentence prevents the holding period from being thus confined when the gain or loss is accelerated under Section 44 (d), and substitutes an enlarged period expressed in terms of the time which the original property shall be considered as being held. The holding period thus begins when the original property was acquired and ends when the installment obligation is disposed of. This reaches the same result as the "tacking" permitted by Section 117 (c) in other cases where the property was received in a non-taxable transaction or with a substituted basis.

Though the statute seems clear, the Committee Report on the Revenue Bill of 1934 is not. The new sentence was added to the bill in the Senate, and the Senate Finance Committee Report (73d Cong., 2d Sess., S. Rept. 558, p. 29) states as follows:

> "This amendment to the House bill makes it clear that where the profit on the sale or exchange of property is returned on the installment basis by spreading the profit over the period during which the installment obligations are satisfied or disposed of, such profit shall be taken into account under the brackets set forth in section 117 of the bill according to the period for which the original property sold was held rather than according to the period for which the installment obligations were held. For example, A sells property held for six years for twice its cost and returns the income on the installment basis. A year and a half later A sells a $100 note received on the sale for $80. Applying the amendment, the $30 profit recognized comes under the 40 per cent bracket of section 117 and not under the 80 per cent bracket."

It is plain enough from this Report that the applicable holding period was not intended to consist of the period during which the installment obligation itself was held, but beyond this the Report is ambiguous. In the example given, the 80 per cent bracket for 1-2 years could apply only if the time the note was held controlled,—which Congress obviously did not intend. The 40 per cent bracket for 5-10 years, however, would apply whether the holding period was considered to be the time the original property was held (6 years) or the combined time of the holding of the property and the note ($7\frac{1}{2}$ years).

In view of the inconclusive nature of the Committee's remarks, we think this question deserves examination by this Court with a view to determining whether the intention of Congress is that which clearly seems to appear from the language of the statute or is what the court below thought after reading the Report.

Conclusion

This case involves matters of general public interest and importance in the administration of the Federal Income Tax Law which have been decided by the court below in conflict with the decisions of this Court. The questions should therefore be reviewed by this Court and a writ of certiorari should issue for that purpose as prayed in the foregoing Petition.

Respectfully submitted,

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Counsel for Petitioner

Theodore Pearson
William H. Harrar
of Counsel

Dated, New York, N. Y.,
October 20, 1944.

In the Supreme Court of the United States

October Term, 1944

Estate of Henry H. Rogers, Deceased, [illegible]

[illegible] and Central [illegible]

[illegible]

INDEX

CITATIONS

617236—44

In the Supreme Court of the United States

October Term, 1944

No. 618

Estate of Henry H. Rogers, deceased; Albert Stickney and Central Hanover Bank and Trust Company, as Surviving Executors of the Last Will and Testament of Henry H. Rogers, deceased, petitioners

v.

Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 23–39) is reported in 1 T. C. 629. The opinion of the Circuit Court of Appeals (R. 103–105) is reported in 143 F. 2d 695.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 24, 1944 (R. 105). The petition for a writ of certiorari was filed on

October 21, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Where the executors of decedent's estate, having made an installment sale within the meaning of Section 44 (b) of the Revenue Act of 1936, later transfer some of the installment obligations from the estate to various trusts created under the will of the decedent and also transfer other installment obligations to an escrow agent for a residuary legatee, whether the installment obligations have thereby been "distributed, transmitted, sold, or otherwise disposed of" within the meaning of Section 44 (d).

2. Whether the capital gain resulting from the installment sale may be deducted from the gross income of the estate under Section 162 (c) as an amount of estate income "properly paid or credited during such year" to the residuary legatees.

3. Whether 60% or 80% of the gain from the installment sale of the stock in question should be taken into account in computing net income under Section 117 (a). This depends upon whether the period during which the installment obligations were held may be tacked on to the period during which the stock was held.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 44. INSTALLMENT BASIS.

* * * * *

(d) *Gain or loss upon disposition of installment obligation.*—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. This subsection shall not apply to the transmission at death of installment obligations if there is filed with the Commissioner, at such time as he may by regulation prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the person receiving any payment on such obligations, of the same proportion of such payment as

would be returnable as income by the decedent if he had lived and had received such payment.

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

* * * * *

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

* * * * *

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * *

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or

> credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

STATEMENT

The facts found by the Tax Court as stipulated (R. 24, 51–99) which are involved in this appeal may be summarized as follows:

This proceeding was maintained by the surviving executors of Henry H. Rogers who died on July 25, 1935, a resident of the State of New York. Among the assets of the estate were about 24,000 shares of common stock of the Virginian Railway, which had a fair market value at the date of death of about $1,400,000. (R. 24.) The executors sold the stock and received about $809,000 in cash and collateral trust notes of $2,400,000 principal amount in payment. The collateral trust notes had a fair market value equal to their face value. (R. 26.) Since the cost basis of the stock was about $1,400,000 (the value at the date of decedent's death), the executors derived a gain of about $1,700,000. The executors treated the sale as an installment sale and reported the gain on the installment basis, which the Commissioner questioned in his deficiency notice. (R. 26–27.) The Tax Court decided that the sale was an installment sale (R. 27), and no appeal was taken by the Commissioner from that part of the Tax Court's decision.

During the taxable year 1937, and about ten months after receiving the collateral trust notes, the executors transferred some of them in the amount of $1,250,000 to themselves as trustees of various residuary trusts under the will and an additional $250,000 of the notes to a bank as escrow agent for a residuary legatee. (R. 30.) Under these circumstances, the Commissioner argued before the Tax Court that the executors had "distributed, transmitted, sold or otherwise disposed of" installment obligations in the amount of $1,500,000 in the year 1937, and that the proportionate part of the gain deferred upon the installment sale should have been reported by the estate under the terms of Section 44 (d) of the Revenue Act of 1936. (R. 31–32.) The Tax Court upheld the Commissioner on this issue.

The executors contended that they were entitled to an offsetting deduction under Section 162 (c) of the Revenue Act of 1936 upon the ground that the income so taxed to the estate was "properly paid or credited during such year" to the residuary legatees. (R. 34–35.) But the Tax Court decided that there had been a distribution of corpus, not of income, and that the executors were not entitled to a deduction under Section 162 (c). (R. 38.)

The final argument made by the executors befor the Tax Court was that 60% of the gain should be taken into account under the terms of Section 117 (a) rather than 80%, because the pe-

riod during which the installment obligations (collateral trust notes) were held should be added to the period during which the railway company stock was held. (R. 38.) The Tax Court held that the 80% rate applied because only the period during which the stock was held should be taken into consideration under the statute. (R. 39.)

The executors appealed to the Circuit Court of Appeals, which affirmed the decision of the Tax Court. (R. 105.)

ARGUMENT

1. Section 44 (d) of the Revenue Act of 1936, *supra,* provides in part that if an installment obligation is distributed or otherwise disposed of, gain or loss shall result. The Commissioner determined and both the Tax Court and the court below decided that the executors had "distributed," or "disposed of" $1,500,000 of the installment obligations during the taxable year within the meaning of Section 44 (d). The transfer of the obligations from the accounts of the estate to the trust accounts, and from the estate to an escrow agent for a residuary legatee, as evidenced by the account filed in the Surrogate's Court and duly confirmed and approved by that court, would seem clearly to come within the meaning of "distributed, * * * or otherwise disposed of" in Section 44 (d). Congress used the words "distributed" and "disposed of" in the usual, ordinary and every-day meaning of those terms. See

Old Colony R. Co. v. *Commissioner,* 284 U. S. 552, 560 and cases cited. In the ordinary and every-day meaning of the words "distributed" and "disposed of," the decedent's estate distributed or disposed of the installment obligations when it transferred them to the various trust estates and to an escrow agent for a residuary legatee. The fact that the trustees happened to be the same persons as the executors is immaterial because they were not the same legal entities in the capacity of executors as they were in the capacity of trustees. See *Maguire* v. *Commissioner,* 313 U. S. 1, 7; *Helvering* v. *Gambrill,* 313 U. S. 11.

The Congressional Committee reports show that the purpose of Congress in enacting Section 44 (d) was to prevent evasion of taxes in connection with the transmission of installment obligations upon death, their distribution by way of liquidating or other dividends, or their disposition by way of gift, or in connection with similar transactions. The reports [1] expressly read in part:

> To prevent the evasion the subsection terminates the privilege of longer deferring the profit if the seller at any time transmits, distributes, or disposes of the installment obligations and compels the seller at that time to report the deferred profits.

[1] H. Rep. No. 2, 70th Cong., 1st Sess., p. 16 (1939-1 Cum. Bull. (Part 2), 384, 394-395); S. Rep. No. 960, 70th Cong., 1st Sess., p. 24 (1939-1 Cum. Bull. (Part 2), 409, 425-426).

In this case the sellers (the executors of the decedent's estate) distributed or disposed of the installment obligations when they transferred the notes to themselves as residuary trustees of the decedent's estate and to the escrow agent for a residuary legatee. Therefore, under the statute they were compelled at that time to report the deferred profits.

While there are no authorities directly in point, there are several analogous cases which tend to support the decision of the court below. *Crane* v. *Helvering,* 76 F. 2d 99 (C. C. A. 2d); *Waddell* v. *Commissioner,* 102 F. 2d 503 (C. C. A. 5th); *Marshall* v. *United States,* 26 F. Supp. 580 (S. D. Cal.). The petitioners do not allege that there is a conflict between the decision of the court below and the decision of another Circuit Court of Appeals; but they do allege that the decision of the court below conflicts in principle with the following decisions of this Court: *Brewster* v. *Gage,* 280 U. S. 327; *Maguire* v. *Commissioner, supra; Helvering* v. *Gambrill, supra; Helvering* v. *Campbell,* 313 U. S. 15; *Helvering* v. *Reynolds,* 313 U. S. 428; and *Cary* v. *Commissioner,* 313 U. S. 441. Each of those cases involves substantially different facts from the instant case and none of those cases involves the application of Section 44 (d) of the Revenue Act of 1936 or the corresponding provision of another Revenue Act.

2. Section 162 (c) of the Revenue Act of 1936, *supra,* provides in part that the net income of the

estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that in the case of income received by estates of deceased persons during the period of administration of the estate, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee or beneficiary.

The purpose of the statute is plain. Income of an estate is taxable either to the beneficiary or to the estate. If the estate properly pays the income to a legatee or beneficiary, the estate is allowed a deduction for the amount so paid, but the amount so allowed as a deduction shall be included in the gross income of the legatee or beneficiary. In this case the income in question is in the form of a capital gain derived from the sale of stock by the executors. The will of the decedent contains no provision in regard to income of the estate during administration, but Article Twenty-third of the will expressly provides that capital gain shall be considered principal and not income. (R. 83.)[2]

Moreover, in their accounts filed with the Surrogate's Court the executors treated the payments as "Payments of Principal to * * * the Beneficiaries." (R. 90.) Also, the Tax Court found

[2] There is a clerical error in the opinion of the court below where the word "depreciation" (R. 104, par. 2, line 6), appears instead of "appreciation" (R. 83, line 10).

as a fact that the trustees did not report any income distributed in their tax return. (R. 35.) Under these circumstances, we think that both the Tax Court and the court below were justified in concluding that the decedent's estate was not entitled to a deduction under Section 162 (c), because they did not distribute any income of the estate *as income* to legatees or beneficiaries. Whatever they paid out they paid as principal, as shown by their accounts and by the language of the will and by the Surrogate Court's approval of their accounts.

The decision of this Court in *Burnet* v. *Whitehouse,* 283 U. S. 148, tends to support the decision of the court below. In that case the testator provided in his will for an annuity to his widow to be paid out of principal if income was not sufficient. In the taxable year income was available for the payment of the annuity. This Court held that even though the amount distributed by the trust was trust income, it was not taxable to the beneficiary because it was paid as corpus. In the instant case likewise the capital gain which the executors transferred to the several trusts was paid as corpus, not as income.

The petitioners allege that the decision of the court below is in direct conflict with the decision of this Court in *Helvering* v. *Butterworth,* 290 U. S. 365. (Pet. 8–9.) This Court decided a group of four cases in one opinion; since the trustee was allowed to deduct the amount of trust in-

come paid to the beneficiary in three out of the four cases, we assume that the petitioners rely upon the decision in those cases. In those cases the will gave the residue of the estate to trustees to pay the net income to the widow. The Government argued that since the widow had taken under the will in lieu of dower and had not yet received the value of her dower interest, the payments to the widow were not income under the rule of certain Circuit Court of Appeals decisions. This Court refused to accept the reasoning of those cases, and decided that the widow was a beneficiary within the meaning of the statute, to whom income was paid in that capacity. The instant case is substantially different in its facts. Under the will in this case, there is no provision for the payment of trust income to beneficiaries. The basis of the decision below lies in this critical fact. The decision does not rest, as assumed by taxpayer, upon any concept that income to the estate lost its character when transferred.

3. Section 44 (d) of the Revenue Act of 1936, *supra,* provides in part that any gain resulting shall be considered as resulting from the sale of the property in respect of which the installment obligation was received. Applying that clause of Section 44 (d) to the facts of this case, the gain resulting from the disposition of the installment obligations would be considered as resulting from the sale of the railway company stock. The purpose of that clause in Section 44 (d) is shown by

the Congressional Committee Reports,[3] which provide in part:

> This amendment to the House bill makes it clear that where the profit on the sale or exchange of property is returned on the installment basis by spreading the profit over the period during which the installment obligations are satisfied or disposed of, such profit shall be taken into account under the brackets set forth in section 117 of the bill *according to the period for which the original property sold was held rather than according to the period for which the installment obligations were held.* [Italics supplied.]

As both the Tax Court and the court below pointed out in their opinions, Congress did not intend to permit taxpayers entitled to the privilege of deferring the report of realized gain to drop into the lower brackets on the basis of the length of time the *installment obligations* were held. The gain was realized at the time of the sale and would have been taxable at that time in full but for the privilege granted of paying the tax as the unpaid installments were received. The gain "resulting" upon disposition of the installment obligations was the gain that had been realized upon the sale or exchange of a capital asset, namely, the railway company stock, and that as-

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[3] S. Rep. No. 558, 73d Cong., 2d Sess., p. 29 (1939–1 Cum. Bull. (Part 2) 586, 608); see also H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 18 (1939–1 Cum. Bull. (Part 2) 627, 629).

set ceased to be held by the executors of the decedent's estate at the time of the sale. The applicable holding period was the length of time the stock was held.

The petitioners do not allege that the decision of the court below on this point is in direct conflict with the decision of any other court.

CONCLUSION

The decision of the court below is correct upon all three issues raised by the petition for a writ in this case. There is no conflict of decisions upon any one of the issues. The petition for certiorari should be denied.

Respectfully submitted.

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